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White Paper

Finding Cash in a Cash-Strapped World

Article 1 in a series of 3 articles

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Increase Profit by Removing Inefficiencies in the Financial Supply Chain

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Table of Contents

1 Introduction

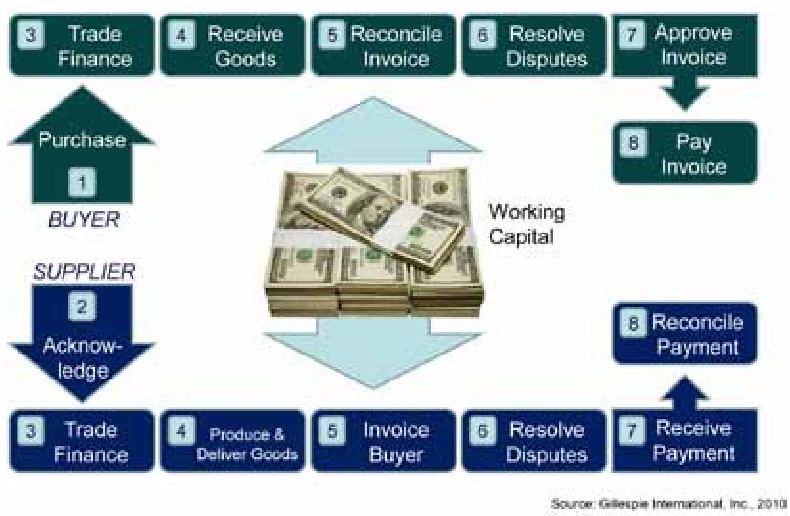
From sourcing to settlement, companies use archaic, error-prone processes laden with redundancy that depending on the size of the company, costs millions, if not billions of dollars. Fortunately, companies can increase their bottom line and show additional value to shareholders, investors and analysts by improving their financial supply-chain (FSC) processes. Available technology enables companies to correct inefficiencies and empowers executives to make more strategic decisions, which increases a company's competitive advantage in addition to its bottom line. Companies that fail to embrace process improvement, automation and straight-through processing (STP) in their financial supply chain will become non-competitive due to higher cost of goods sold, lost profit and higher operational risk.

2 Financial Supply Chain Analysis

The financial supply chain has multiple points where transaction processing time drains working capital. In fact, every point (identified in Chart 1, below) has multiple possibilities of inefficiencies and opportunities for re-work and delay, which reduces profit.

Not only are costs incurred due to inefficient processes and overpayments to suppliers, they also arise from excessive customer delivery time and extended expense settlement time with suppliers. Time is money: Each transactional error in the purchase-to-settlement

Chart 1: Financial Supply Chain Opportunities



progression triggers re-work, which is often paper-based, tedious and time consuming – typically impacting both the buyer and the supplier. Re-work frequently delays the next steps in the financial supply chain, and often results in additional errors within the remaining steps. An incorrect purchase order often leads to an incorrect invoice, which leads to an elongated period for invoice reconciliation, delayed payment and incorrect payment amounts.

Delays in the financial supply chain also impact the buyer's days payable outstanding (DPO) and the supplier's days sales outstanding (DSO). Buyers with higher DPO are missing discount opportunities, which today can represent an annualized return of more than 37% using common payment terms. A review of case studies found that early pay discounts could amount to approximately U.S. $2.2 million per U.S. $1B spend.[1] Higher DSO negatively impacts internal cash flow for suppliers. A large U.S. retailer, for example, found that reducing its DSO by 1% generated U.S. $4B in internal cash flow.[2] Contrary to popular belief, squeezing customers for early payment while delaying payment to suppliers is neither a viable way to optimize cash flow, nor a good way to achieve an efficient supply chain. Both supplier and buyer must benefit from a transaction for the financial supply chain to be successful and efficient.

3 Financial Supply Chain Optimization

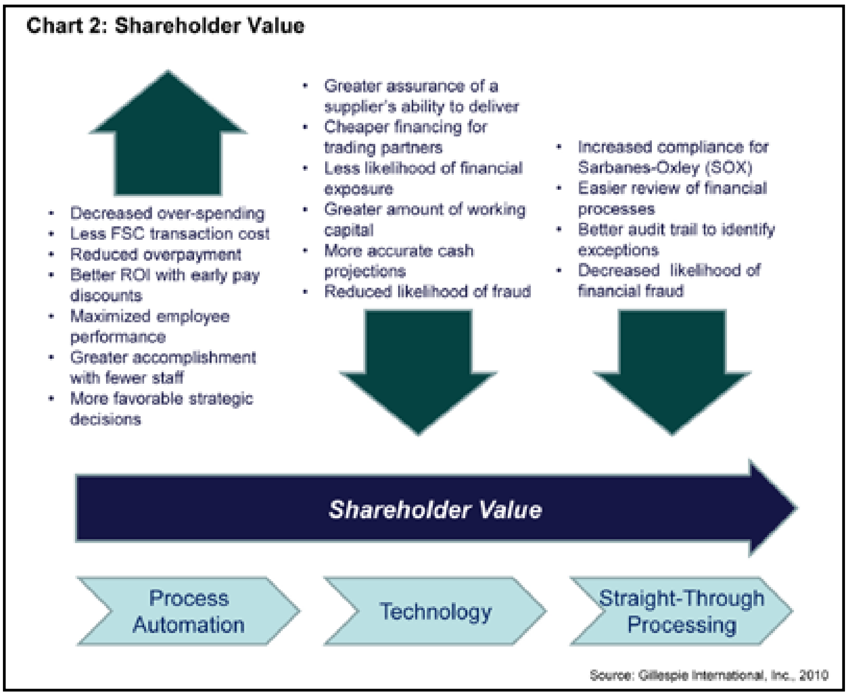
The path to realizing bottom-line improvements requires three things:

1) Process improvement: A best practice begins by mapping existing processes, eliminating unnecessary steps, removing all duplication and streamlining the remaining processes.

2) Technology: Once a process is streamlined, it should be automated and digitized to enable transaction visibility across the financial supply chain, whether it be cash balances, payables, receivables, inventory, etc.

3) Straight-through processing: Transactions without errors or that meet predefined criteria should become "touchless," requiring no human intervention.

An optimized financial supply chain provides value to shareholders in three ways: Increased profit, reduced operational risk, and lower executive risk (as shown on Chart 2, below).



Profit is increased in multiple ways, for example:

- Automation enables procurement departments to incorporate a global spend strategy and enforce it, minimizing maverick spending and supplier management, enabling staff to work more efficiently and process orders on time. For example, a leading consumer packaged goods company found it could add a 21% savings from spend directly to profit margin by creating and using a global spend strategy. It added another 9% average savings by consolidating suppliers in small-value spend categories.[3]

- Accounts receivable departments can accelerate the payment process and reduce DSO by providing an accurate, digitized invoice to the approving buyer, which results in reduced reconciliation efforts between buyers and suppliers.

- Accounts payable departments can be empowered to identify spending outside negotiated terms, recognize invoice overcharges and take early pay discounts — in less elapsed time and staff is freed for more strategic efforts. ROI increases due to the early pay discounts (a review of multiple case studies found billing errors can be reduced up to U.S. $1.8 million, contingent on spending volume).[4] Even more importantly, visibility into corporate spending empowers companies to make strategic decisions such as changes in suppliers, moves to outsourcing, moves to in-house processing, and even changing the location of a distribution center.

When electronic processing was first introduced, the value was believed to be the reduced transaction processing cost; however, experience demonstrates the real value is use of accumulated data in strategic decision-making.

Operational risk is reduced with more visibility into the financial supply chain. Visibility allows suppliers (and buyers, if necessary) to obtain quicker and cheaper financing, often based on the buyer's credit rating, at just the right time — increasing the likelihood of a supplier's ability to deliver. Managers have a more accurate picture of the company's finances, which enables them to control exposure from cash balances, payables, and receivables. Working capital increases due to less spending, which enables companies to take advantage of internal financing, which is a much lower cost than external financing. Standardized transaction processing and detailed audit trails decrease the likelihood of fraud in the operation.

With the introduction of the Sarbanes-Oxley (SOX) Act of 2002, executives, particularly CEOs and CFOs, are held accountable for company financial reporting. Not only can technology and automation improve SOX compliance, it also serves as a "Stay Out of Jail" card for executives. Automation forces processes to be well-defined and easily reviewable, while creating an impeccable audit trail. As a result, exception processing is more easily detected. Once detected, the exception can be validated or corrected, reducing the likelihood of wide-spread fraud within an organization.

4 Bottom-Line Results

Benefits of financial supply chain optimization are best seen by comparing differences between best-in-class performers and the rest of the population (such as average performers and laggards). Between April 2007 and December 2009, Aberdeen Group looked at performance in procurement, accounts receivable, and accounts payable departments (see Chart 3).

As a result of its research, Aberdeen classified companies into three groups: best-in-class, industry average and laggard, which fell into a 20:50:30 ratio. Companies in the best-of-class category improved processes and embraced technology that moved them toward STP, while companies in the average and laggard categories lost money unnecessarily and significantly diminished their ability to compete. Aberdeen found the following results for each category:

Chart 3: Mean Performance of Companies[5]

Department	Category	Mean Performance Best	Mean Performance Average	Mean Performance Laggard
Procurement	Spend under-management	85%	59%	26.7%
	Contract compliance	81%	55%	15%
Accounts Receivable	Complete and on-time shipments	97%	91%	82%
	Days sales outstanding (DSO) fewer than 30 days	51%	12%	7%
	Invoice within three days of shipping	80%	38%	12%
Accounts Payable	Cost to process an invoice	$2.18	$9.38	$34.11
	Number days to process an invoice	2.8	15.8	35.1
	Days Payables Outstanding (DPO)	34	41	56

Data Source: Aberdeen Group

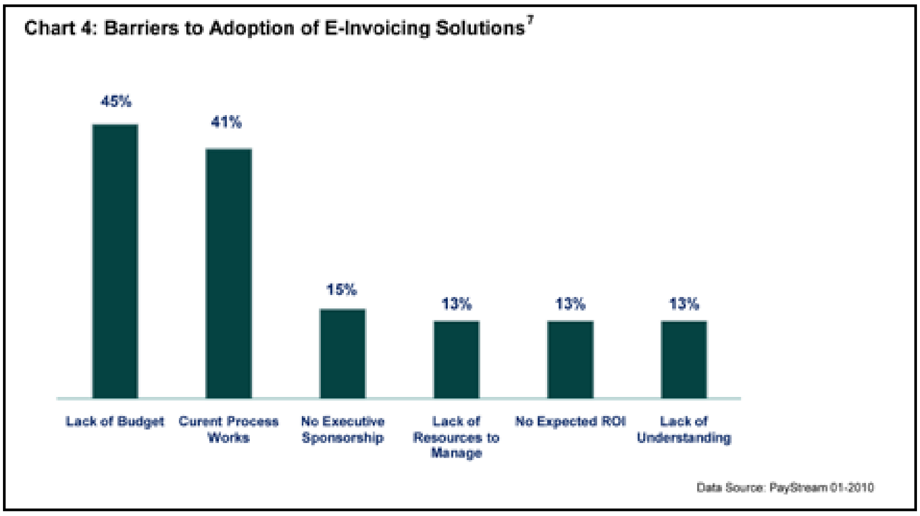
- Procurement: Companies that manage spending and reinforce contract terms save money. They pay less for everything from everyday supplies to raw goods for manufacturing. These companies have implemented global procurement strategies, minimized the number of suppliers used and negotiated top rate pricing from suppliers — creating savings that contribute directly to the bottom line.

- Accounts receivable: Companies that invoice promptly (within three days of shipment) have lower DSO, and therefore better cash flow.

- Accounts payable: Companies that take fewer days to process an invoice spend less money on invoice processing, which contributes directly to the bottom line. Best-in-class companies issue invoices more quickly and pay invoices more promptly. Companies with high processing costs are not able to compete with more efficient companies. For example, take the cost to process a single invoice: A best-in-class company spends U.S. $2, and a laggard company spends U.S. $34: The cost difference to process 100,000 invoices is U.S. $3.2 million. A company that spends U.S. $3.4 million to process invoices cannot compete with a company paying U.S. $200,000. Cash discounts are impossible for a company that takes more than 10 days to process an invoice. Assuming the company has the cash on hand for early payment, it is forfeiting a huge ROI — ranging anywhere from 7% to 55%, contingent on the payment terms.[6]

5 A New Mindset

As executives move their companies into the 21st century, they must understand the power of the financial supply chain and view the world differently than in the past. Procurement and finance departments, typically seen as cost centers, can increase a company's bottom line with the proper tools. Collaboration among departments and among trading partners can add profit dollars. Archaic processes can cost huge sums, subtracting directly from a company's net profit. We recommend companies observe the following:



- If It Is Broken, Fix It: Research done earlier this year by PayStream surveyed respondents about the barriers to invoice automation. The research found that the No. 2 reason for a company failing to automate invoicing, second only to budget, was a management belief that current processes work (see Chart 4 above for complete survey results).

  Unfortunately, this belief could not be further from the truth. The Aberdeen Group's study of best-in-class practices demonstrates that current processes are not working for about 80% of corporations — if not more. Until executives understand the power of the financial supply chain and set aside budget dollars to institute these technology-driven improvements, these inefficiencies will continue. Companies will continue to be sub-performers until the company ceases to exist. Non-efficient companies with higher costs of goods sold and lower profit ratios simply cannot compete with efficient companies that optimize their cash.

- Collaboration improves corporate performance: Cash, always important, is especially critical in a tough economic environment when credit is practically non-existent. The importance of cash is transforming corporate focus from just-in-time (JIT) delivery of goods to JIT delivery of cash. No longer is it sufficient for a company to simply know the amount of cash on hand. A company must have complete visibility into its financial supply chain to optimize its cash on hand. The need for money in a cash-strapped world has brought about more collaboration in the financial supply chain. As automation and technology functionality improves, collaboration will increase and cash will be more tightly managed as buyers and suppliers dynamically change payment terms.

- No process is sacred: Internal processes have long been untouchable within the organization. In fact, companies often make technology purchase decisions based on which product best supports existing internal processes. Companies spend millions of dollars on new, innovative technologies and thousands more to customize the new technology to conform to archaic processes. It is vital to apply new technology along with process improvement. No process should go without scrutiny. Companies must make continuous process improvements – removing redundancies and streamlining procedures.

6 First Steps

Moving toward STP and full visibility of the financial supply chain first requires executive vision and sponsorship. It is important to understand existing processes and know their costs, which is often a barrier to ROI calculation and budget justification. Once you understand your processes, improve and automate them. Automation can save money and increase corporate profitability, providing additional wealth to shareholders and investors while increasing company value to analysts. Proactively budget for automation: If it becomes an afterthought, funding may be too scarce when needed. Challenge and reward your staff for innovative thinking and process redesigns. Seek continuous process improvements. Move into the 21st century, or risk greeting the next decade with failure.

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[1]Aberdeen Group, 2005; Gartner Research, 2004; IOMA Benchmark Report, 2005.
[2] "Latest Trend: Companies Paying Suppliers More Quickly," Treasury &Risk, February 2010, p 11.
[3] Mickey North Rizza, "Spend Visibility: Do You Have the Correct Lens?," AMR Research, Supply Management, December 2009.
[4] Aberdeen Group, 2005; Gartner Research, 2004; IOMA Benchmark Report.
[5] Aberdeen Group, April 2007, September 2008, November 2009, December 2009.
[6] Based on calculation of annualized interest rate for payment terms ranging from 1/10 net 60 to 1/10 net
[7] PayStream Advisors, eInvoicing Adoption Benchmarking Survey, Q1 2010.

About Basware

Basware is the global leader in purchase-to-pay solutions with more than 1,500 customers and 1,000,000 users in over 50 countries around the world. With Basware, organizations can reduce the cost of buying and paying for goods and services and gain visibility and control of their entire spending process by automating manual processes, from sourcing, contract management, purchasing and supplier collaboration to invoice automation.

Basware solutions and services enable substantial cost reductions across businesses and deliver value by providing compliance and control, as well as fast return on investment. The solutions are distributed and implemented, either on site or as a service, in Europe, the US, and Asia-Pacific through an extensive network of Basware offices and business partners. For more information please visist www.basware.com/us.

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